MID TERM I

I. Short Answer Questions – Please keep them short and to the point

1. Name 4 countries that are joining the EU in 2004.
   
i. __________________
   
ii. __________________
   
iii. __________________
   
iv. __________________

2. Did the original 6 member countries decide to create the European Coal and Steel Community in 1953 for purely economic reasons? Yes or no
   Explain.

3. Which EU institution actually carries out the EU affairs (for instance negotiates trade agreement with non-members)?
   
Is this institution answerable directly to specific national governments? Yes or no

3. Where is the Commission located?

4. Why is the concept of subsidiarity better served by legislating through directives than through regulations.
5. Originally the EU budget relied mainly on revenues collected through the Common External Tariff. Explain what happened to these revenues.

6. Assume that a small country sets a quota equal to 100 cars. As a result the domestic price of car is raised by 50% over the world price (free trade price). Let’s now assume that, due to a prosperous year, the domestic demand for car increases substantially. (hint: draw a graph)

What will happen to quantity of cars imported?

- Increases
- decreases
- stays the same

What happens to the domestic price of cars?

- Increases
- decreases
- stays the same

What happens to the domestic production of cars?

- Increases
- decreases
- stays the same

What happens to the domestic consumption of cars?

- Increases
- decreases
- stays the same

7. What are the differences between a free trade area and a common market? Just list the differences.

8. Why are competitive economies more likely to reap higher benefits from forming a CU than complementary economies?
9. The Single European Act (1986) has “deepening” as well as “widening goals”: can you name 2 areas where the European Community widened its influence as a result? Just list the areas.

10. There are economic justifications for state aid in special circumstances: name 2 such cases.
II. Theory

Two countries France and Germany originally produce automobiles. The 2 countries have similar economies overall. As a result they set prohibitive tariffs to protect their industries.

How do you describe such economies? 

As these 2 countries have similar size, income, and taste, each faces the same domestic demand curve $D_F$ for France and $D_G$ for Germany.

Since these 2 countries are not that large compared to the US or Japan, automobile production takes place somewhere on the downward sloping branch of the marginal cost (or supply) curve.

If anyone of these 2 countries were able to expand its domestic production of automobile by taking over the total market for automobiles of the 2 countries, that country would be able to reap the benefits of 

Let’s assume, that at each level of production, the German marginal costs are always lower than the French marginal costs. Label the French and the German supply curve on the graph below $S_F$ and $S_G$ and show the French and the German autarky prices $P_F$ and $P_G$.

When France and Germany form a customs union, will one country dominate the automobile market? Yes or no

If so: which country? 

Show the customs union price $P_{cu}$ on the graph below.

Let’s also assume that the other world producers are very large and no change in the demand of either France or Germany or of both France and Germany will ever affect the world price for automobiles $P_w$.

When the 2 countries form a customs union, is it possible for the CU to dominate the world market? Yes or no

If so, complete the graph below illustrating such an instance: i.e. draw the world supply $S_W$ corresponding to price $P_w$ and consistent with the assumption of the CU dominating the world market.
Show the welfare gain or loss for France by shading and naming the relevant area(s).

Specify the source of the gains or losses.
III. Problems

Let's assume that, in autarky, a bottle of red table wine (750ml) costs

$14 in Ireland,
$9 in Greece, and
$8 in Portugal. (All prices are quoted in dollars and there is no inflation during the time span of the problem.)

Assume that Portugal can produce any amount of wine at $8.

Assume that if the price of the foreign supply is equal to the domestic autarky price, each of these countries will consume the domestic supply rather than import.

Case A - The year is 1982: Ireland protects its wine producers with a $3 par bottle specific tariff (the common external tariff on wine imports set by the European Economic Community or EEC) while the Greek (specific) tariff is $4 per bottle of wine imported. (The cost of transportation of wine between any two European countries is negligible and none of the other EEC countries are either producers or consumers of red table wine.)

What is the domestic price in Ireland
of Irish wine
of Greek wine
of Portuguese wine

What is the domestic price in Greece
of Greek wine
of Irish wine
of Portuguese wine

Will the Irish import wine? Yes No If so from whom? _____________
Will the Greek import wine? Yes No If so from whom? _____________

Case B - The year is 1983: Greece joins Ireland in the European Economic Community, a customs union. All internal tariffs are suppressed between the members of the EEC and Greece adopts the common external tariff on wine. (Note that Portugal will not join until the late eighties.)

Note that the domestic price corresponds to the price that the domestic consumers pay for the wine whether produced at home or imported (so it might include the tariff) while the autarky price corresponds to the supply and demand equilibrium price in a closed economy.
What would be the price in Ireland and in Greece of Portuguese wine? ________

Assume that the custom union equilibrium price settles at $10: at this price, the Irish excess demand for wine is equal to Greece’s excess supply.

Will the Irish import wine?  Yes  No
If so from whom?  __________

Will the Greek import wine? Yes  No
If so from whom?  __________

Use the graphs above to answer the following questions (tick the correct answer).

i. Is the move from case A to case B:
   trade creating/exp only for Ireland  ________  for Greece  ________
   trade diverting only ________  ________
   or both ________  ________
   or neither ________  ________

ii. what happens to Irish consumption to Greek consumption?
   increases ________  ________
   decreases ________  ________
   stays the same ________  ________

iii. what happens to Irish production to Greek production?
   increases ________  ________
   decreases ________  ________
   stays the same ________  ________
Use the graphs in the previous page to carry out a welfare analysis. Show, when relevant, the net gains and the net losses for each country. Shade and name the relevant areas (a, b, c, d, etc.) and specify below the cause of the welfare gain or loss.

Hint: You need to show on the graph for Ireland and for Greece all the relevant prices as well as the old and the new level of trade.

<table>
<thead>
<tr>
<th>Area</th>
<th>Gain or loss</th>
<th>Cause of gain or loss</th>
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<tbody>
<tr>
<td>a</td>
<td>_____</td>
<td>______________________</td>
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<tr>
<td>b</td>
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Case C - The year is 1987: Portugal now joins the EEC/EC with Ireland and Greece. (Remember that the Portuguese supply is infinitely elastic and assume that the Portuguese do no consume any red table wine).

What is the domestic price in the EEC/EC
- of Greek wine __________
- of Portuguese wine __________

Will the Irish import wine? Yes No If so from whom? __________
Will the Greek import wine? Yes No If so from whom? __________